DOW THEORY LETTERS INC.

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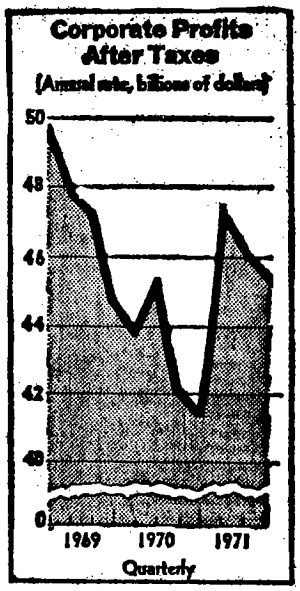
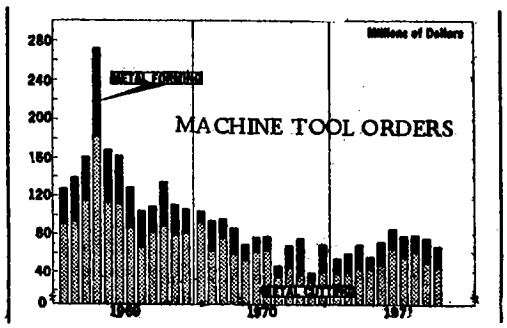
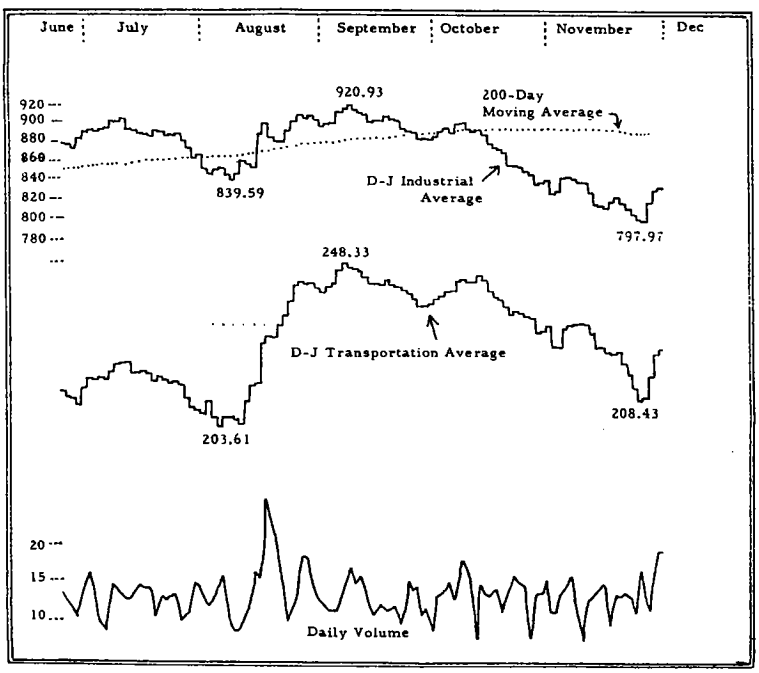
THE PICTURE: I include on this page a chart of machine tool orders. This is considered a lead indicator of what manufacturers are planning for a year or more ahead in the way of new tools, cutters, lathes, grinders, etc., all gauged towards future production. Anyone who believes that this chart is pointing to a forthcoming heavy goods boom will have to explain it to me. Couple this with the "leading indicator" chart shown in a later section of this Letter, and you have a picture which couldn't be further from the big boom fantasy envisioned by Mr. Connally and the Administration.

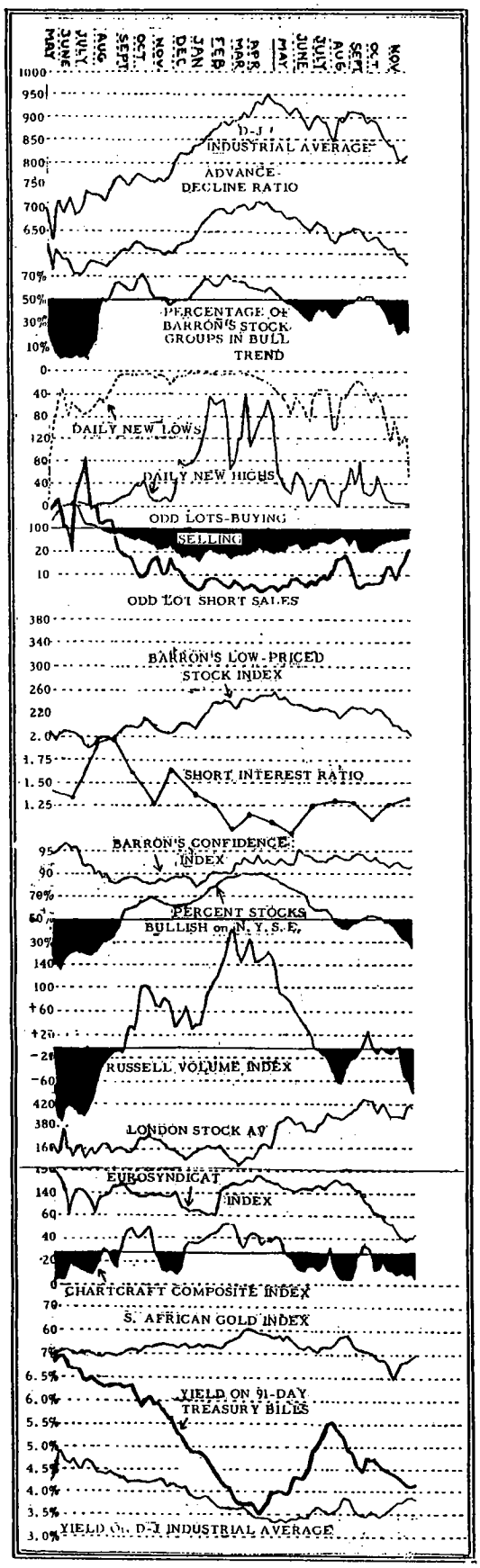


Furthermore, corporate profits after taxes (see chart) are now sliding, sliding not from peak levels but from levels well below the 1969 highs. But the most ominous statistics pertain to the balance-of-payments, which is now running at the worst deficit rate in history, calculated to be $31 billion (deficit) for the full year 1971!

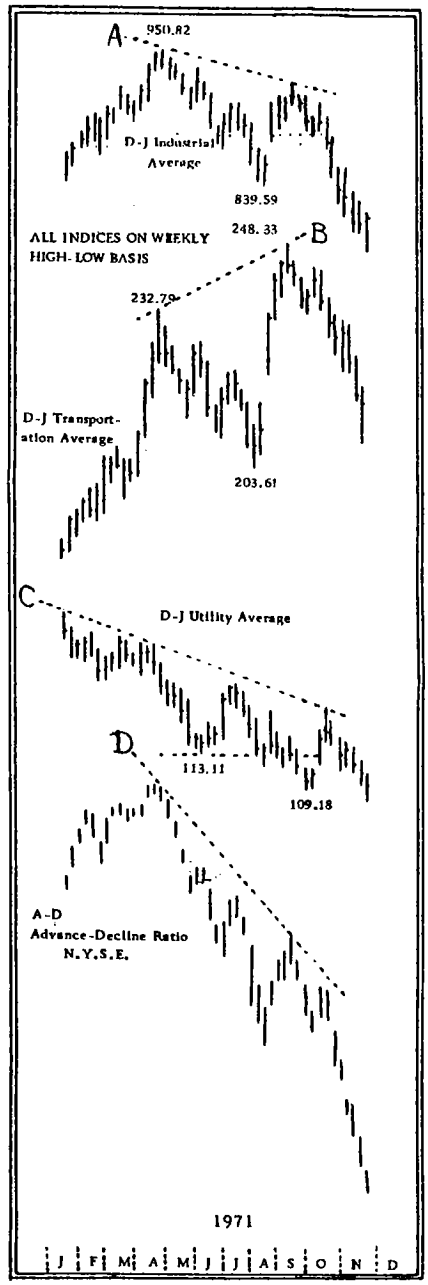
On November 29 it was announced that the budget deficit for the ngle month of October (at a time when the economy was supposed to be "in high gear") was an incredible $6.3 billion! The fact is that all trends point to an absolutely whopping budget deficit for the current fiscal year. I believe that







sliding corporate profits and a corresponding slump in Government tax receipts are fated to be one of the great shocks of 1971-72.



this the market has been discounting in its abrupt collapse from the September highs. e study the long, narrow page 2 chart it is immediately obvious that the advance-decline ratio has suffered a staggering collapse, and this perhaps best reflects what has been happening on the N.Y.S.E. (see stock section at end of report). Moving up on the chart we note that on November 24 the Utility Average broke its preceding 109.18 low, to close at 108.03, a new low for 1971. New lows on the bellwether Utility Average (as I warned in the last Letter) are bearish, in that the investment-grade Utilities tend to move ahead of the other Averages.

As seen on the top of the chart, the Industrial Average made a new low for the year on November 23 at 797.97. The speculative Transportation Average broke to a low for the move (November 23) at 208.43, but note that this was five points above the August low of 203.61. I wrote previously that the only glue holding the technical picture together at this time was the refusal of Transports to break 203.61. This Transport non-confirmation undoubtedly set up the technical conditions which allowed for the rally which began November 26.

Nevertheless, this is a primary bear market, and I want to state that in time the Transports will confirm on the downside by violating their August lows. The page 2 chart is drawn to semi-logarithmic (ratio) scale so that percentages of advances or declines are shown. Thus a rally of 10% on Industrials will appear as exactly the same vertical distance as a 10% rally in Utilities or Transports. The Transports represent the speculative, volatile Average, and observe the much greater, more speculative advance of the Transports during 1971 compared with the early ending of the 1971 rally in the investment-grade Industrials, and compared with the almost steady 1971 decline in the ultra-investment-grade Utilities.

meaning of this is that despite the primary bear market, the speculative element is still very active and raring to go. Further proof of this came when, after filling the frenzied upside "gap" formed on August 16, the Transports, on November 29, produced another upside gap (this time of 86¢). Note: A gap is a space on the chart formed when the high of a given day is below the low of the succeeding day (see Wall Street Journal daily chart of the Averages).

As I see it (and I want to give credit to E. George Schaefer, 916 E. 38th St., Indianapolis, Ind. 46205 for detailing the gap thesis), the greater rise in Transports and the two upside gaps of 1971 in Transports underscore the fact that the speculative element is still rampant in this market, even though the primary trend is down. Such enthusiasm, during a bear market, has the most ominous long-term connotations, and I would say that before this primary bear trend is over, the speculative, enthusiastic buyers who are now running up the Transports and gapping them on the upside, will be pulverized by the ferocity of the liquidation.

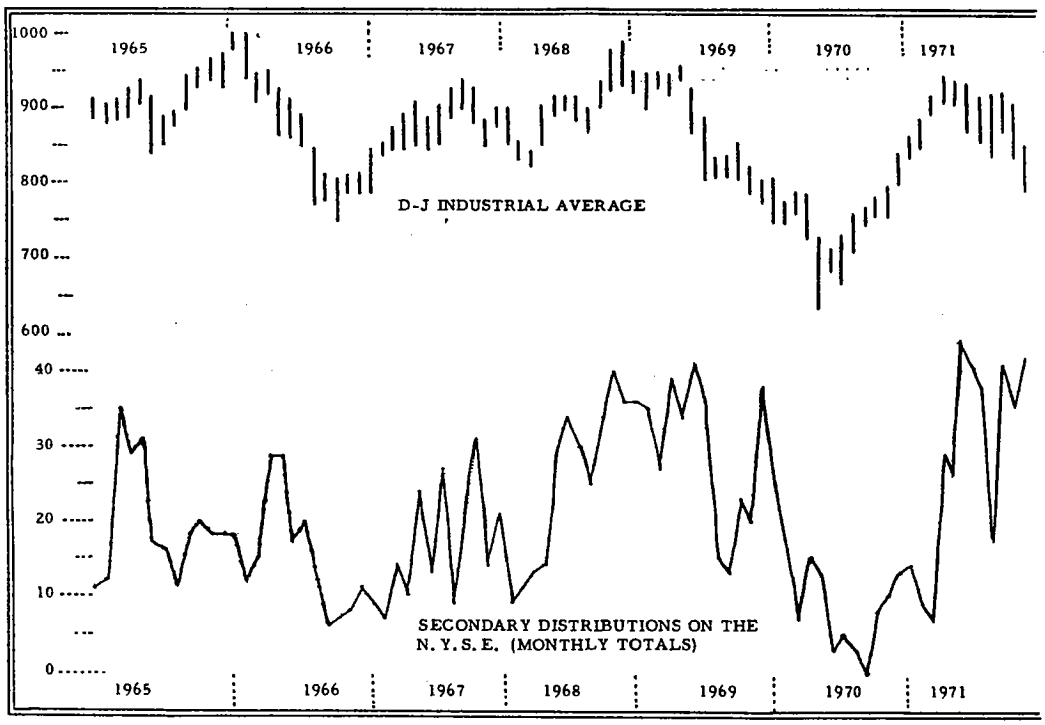
I also want to point to the fact that volume still consistently expands on the rallies and contracts on the declines, even though the market has just sunk to new 1971 lows. This again indicates that the "enthusiasm" is lodged on the bull side of the ledger. I would guess that within a year or so, today's bullish element will be wiped out, and that because there has been so much bullishness during the five years since this bear market began (since 1966), the bear market is fated to be much worse, much deeper and much more vicious than anyone now imagines.

SECONDARIES: For the past few years I have been running a study of secondary distributions on the N.Y.S.E. This week Barron's has picked up the study, and although the chart in Barron's is (unfortunately not up-to-date), the conclusion in the article is the same.

including my chart (page 3) of the monthly totals of secondary distributions. As most readers know, the secondary is usually ery large offering of stock which is distributed on a special basis. It is registered with the S.E.C., and while the secondary is being offered the price of the stock may be "supported". Often, special commissions are given to brokers who sell various portions of the secondary.

The Barron's article puts their secondary distribution index on the basis of a 3-month moving average. When their index rises above 24, the market is said to be a "sale", when below 8 the market is said to be a "buy".

I prefer the single month basis with the general statement that when the monthly figures rise above 30 the market is in a selling zone (or under informed distribution). When monthly secondaries (totals) drop below the 10 area, the market may be in a buying zone. However, during a primary bear market, many other criteria must be applied above and beyond the secondary distribution index (at least for purposes of buying).



At any rate, the latest November figures show 42 secondary distributions for the month, the second highest on record (surpassed only by April, 1971's, 44). The three month average of secondaries is now a whopping 39, high into the danger zone according to the Barron's study.

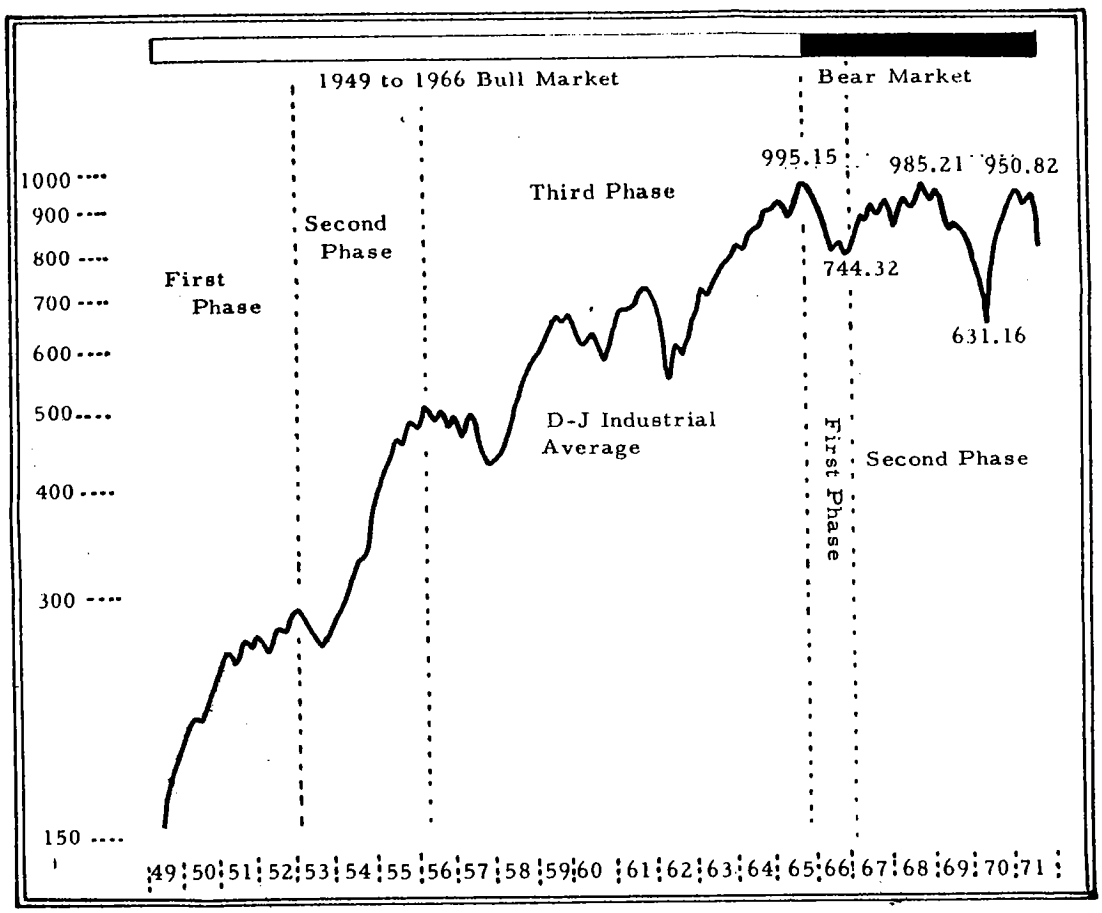
Now here is another important consideration. Note that from a peak above 30 or particularly above 35, it has (historically) taken many months before the secondary index has dropped back below the 10 area again. With this in mind, the secondary index is saying that we are now nowhere near an important bottom for the market. Thus, the market may be considered doubly dangerous at this time, first because it is a primary bear market, and second because the secondary index is indicating massive distribution, even while prices have been going down (this is what occurred during 1969 — see chart).

LOOK AND LISTEN: I feel that the Administration is moving close to the edge of hysteria. Following the Nixon speech before the AFL (which includes 13 million members), the Nixon-Meany feud broke out into the open. Mr. Meany, in what seemed to be a calculated insult, called Mr. Nixon a "weak" and "dangerous" man. I do not know that I agree with Mr. Meany's characterization of the President, but I do know that a situation in which Labor and the Administration are at each other's throats is both weak and dangerous, at least for Wall Street and the nation.

On November 22 Treasury Secretary Connally (who is the unofficial Administration spokesman) took Mr. Meany to task for his words. At the same time, Mr. Connally stated that he believed the market would continue to "fluctuate wildly up and down". He said that the bond market is in "excellent shape", and he made the remarkable statement that the stock market decline is due to people feeling that they no longer need the stock market (as an inflation hedge) because the rise in prices is very nearly halted.

Finally, Mr. Connally noted that "I have great confidence" that "we can approach 1972 with great certainty that we will continue to make progress" against inflation and unemployment.

Unfortunately, I don't agree with very much of what Mr. Connally said on the economic front. Neither Mr. Connally nor Mr. Nixon, nor for that matter anyone else in Government, seems to understand how a great primary bear market works. The irresistable forces of the bear will not be stopped by Presidential edict, by the brave words of the Treasury Secretary, by the laws of Congress or by anything else. That is the most difficult single concept to get over to subscribers, but I will say again that as night follows day, as correction follows excess, as the "seven lean years" follow the "seven fat years", great bear markets follow great bull markets.



We witnessed a great
'l market from
49 to 1966. In February, 1966,(see chart) a primary bear market began. The first psychological phase of the bear market, the phase that traditionally wipes out the "froth", lasted from February, 1966, to October of that year.

From there, the second psychological phase (not to be confused with price movements) began. The second phase (historically this is usually the deceptive phase) took the Dow up to 985.21 in a tremendous, inflation-inspired upward correction. A near-crash then rocked the Dow
'he 631.16 low of
70. A second deceptive rally brought the Dow back to the April, 1971, peak of 950.82. From here the Industrial Average began sliding again. By November 23 the Dow had slipped below the 800 mark, as seen on the chart.

Note also on the chart that the Industrial Average has been fluctuating in a "top" area of 630 to 995 for over five years. There have been three "passes" at the over 950 area, and each of those movements has been met with heavy selling, the latest being the liquidation following the 1971 peak of 950.82. As a rule, the longer the Dow fluctuates in a "top area", the greater the ensuing decline into some deep-down bottom area. Conversely, the longer the market wallows in a bottom area (such as 1946-1949, the greater the ensuing move on the upside.

The five-year top area shown on the chart (mid-1965 to the present) represents the greatest peak "area of distribution" in Wall Street annals. Very few market students are aware of the ominousness of the current price structure (as shown on this chart), but one man who is aware is E. George Schaefer, the outstanding Dow Theorist from the Midwest. In his November 20 report ("The Dow Theory Trader," 910 E. 38th St., Indianapolis, Ind. 46205), Schaefer wrote, "The greatest 'bust' in the history of the U.S. is coming ... and it is approaching with great speed at this time".

My feeling is that the second phase of this primary bear market should be drawing to a close shortly. This means that the market should soon be heading for the 1970 lows, and those lows should be broken. I do not know how they will be broken, but I suspect it could be in a manner that will be violent, tragic and near-disastrous — and with a noise that may be heard around the world.

As for the economy which Mr. Connally is so confident of in 1972, even here my studies do not correspond with his. I am including my chart (page 5) of the percentage expanding of 12 leading indicators which are monitored by the Dept. of Commerce. Superimposed upon the percentage expanding indicators is the Business Week magazine business index which I chart on a middle-of-each-month basis. On the latest reading, I show that only 42% of the 12 leading indicators are expanding, and this is actually a negative reading for the future of the economy.

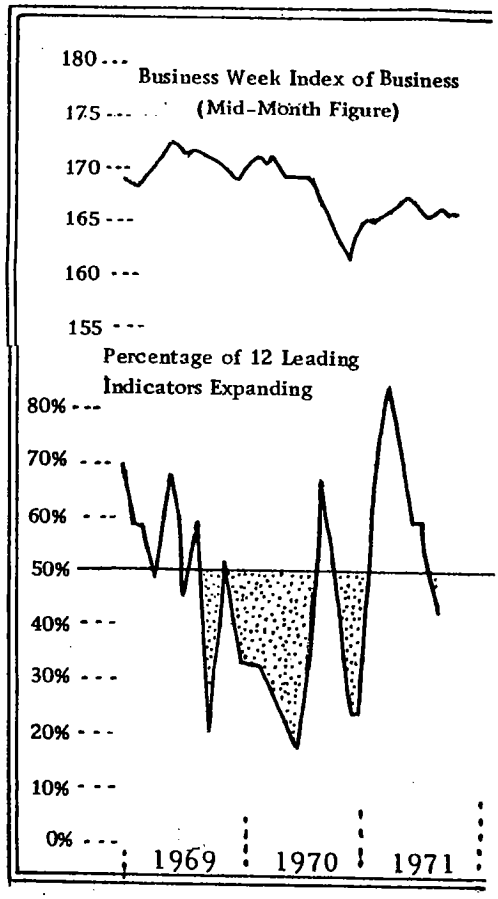
..rthermore, with the recent low point for this indicator coming in early 1970, it is an ominous sign that now, a year-and-a-half later, the percentage of leading indicators expanding is under 50%. (Note: In computing the leading indicators expanding chart, I use the method followed by the Cleveland Trust Co., designating various numbers of months or quarters for statistical significance in computing my figures. Those interested might write for the Cleveland Trust Bulletin No. 9, address of which is Cleveland, Ohio 44101. Incidentally, the Cleveland Trust Bulletin, which is monthly and free, is one of the best in the business).

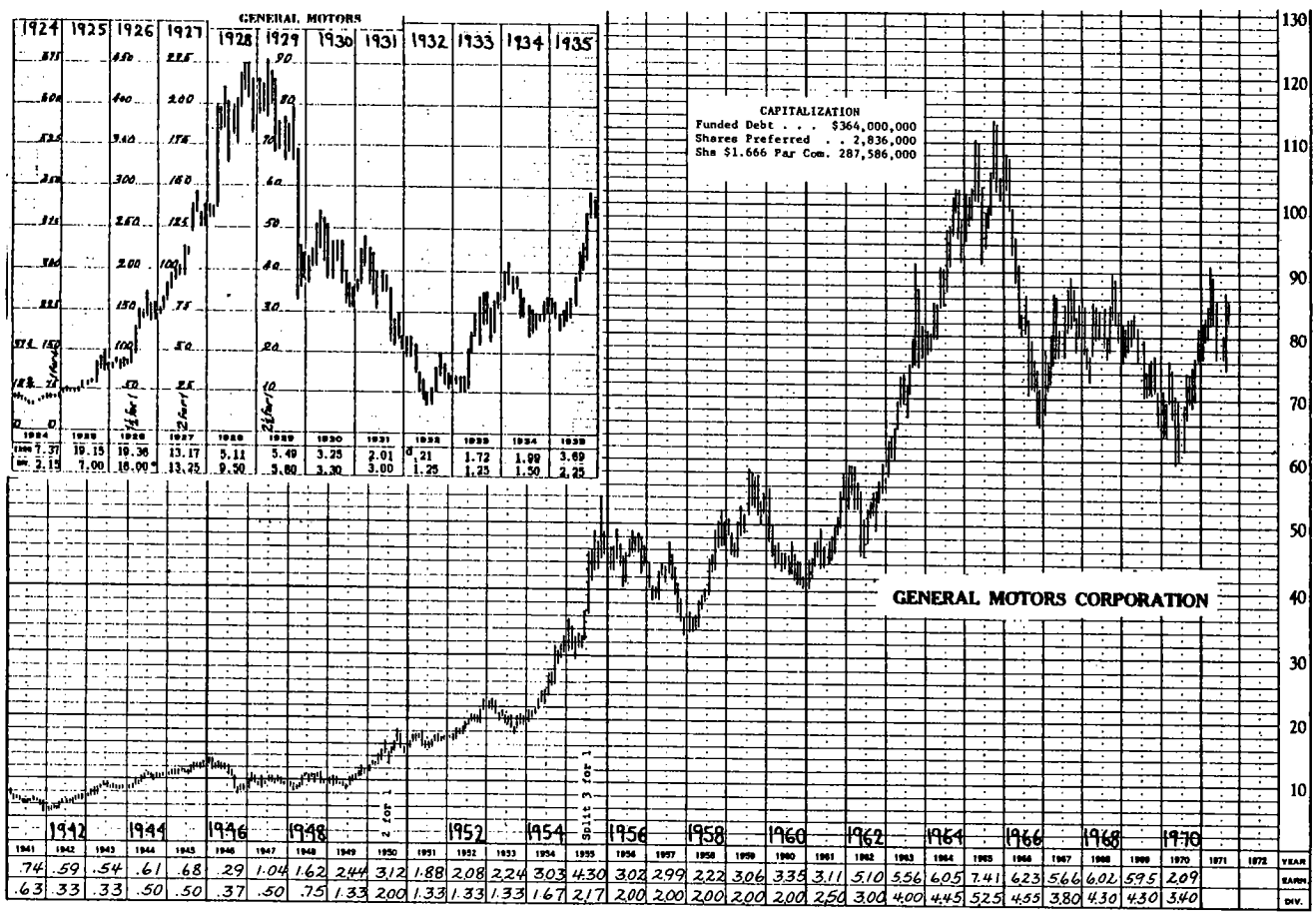
STOCKS: I don't want to belabor the case for or against General Motors, but the company is the world's largest manufacturer with 287 million shares of common stock outstanding. GM is one of the few corporations in the nation so big that a slump in its sales can actually affect the GNP.

I have been drawing attention to the action of GM lately, and at this time I want to offer a rather amazing comparison between the movements of GM during 1929 to 1932 (the time of the Great Crash) and the recent action of GM from 1965 to date. Note the major tops of 1928-29 and 1964-65. Following both tops, GM smashed to lows about a year later (late-1929 and 1966). Then we have the rally to mid-1930 matched by the rally to the 1967 and 1968 peaks in the 90 area. Next we have the decline to late-1930 matched with the decline to late-1970. The rally into early 1931 compares with the rally to early 1971.

Following the 1931 peak of 48, GM fell away to the final 1932 low of 7 3/4, which represented a drop of 83% from its 1931 peak. If GM were to do the same thing from its 1971 high of 91, it would hit a final low of about 17. This is admittedly drastic, but it happened in 1929-32, and I submit that so far, the patterns are extraordinarily similar.

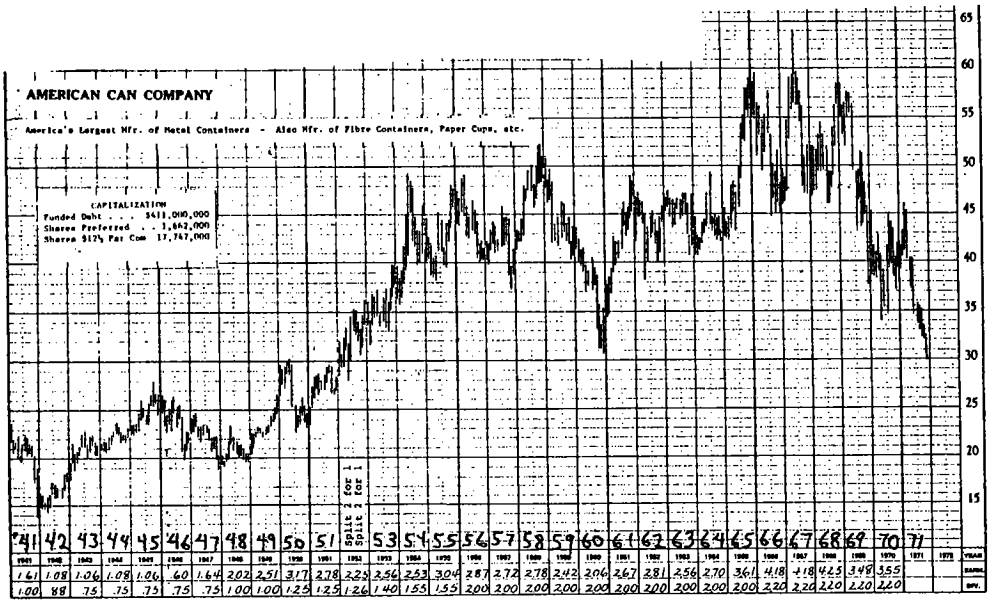
I have also included very long-term charts of Anaconda and American Can, both "blue-chip" type companies (although there is a question now of whether any metal company can be termed blue-chip). I turn to these charts because I believe they are the forerunners of the coming depression. In his November 23 Janeway Letter, economist Eliot Janeway notes that "The consensus in vogue for some years has been writing off the importance of the primary producing stocks ...My dissent has expressed the premise that any country is kidding itself if it thinks it is doing well as 'an economy of services' making its big play on earnings



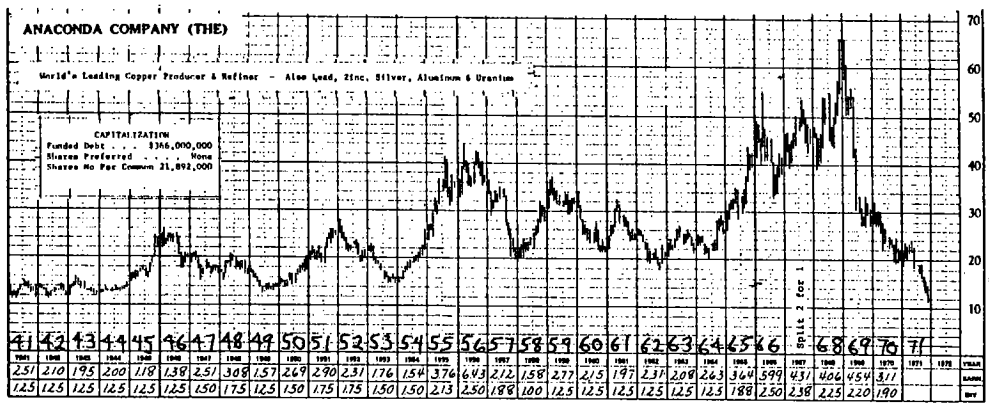


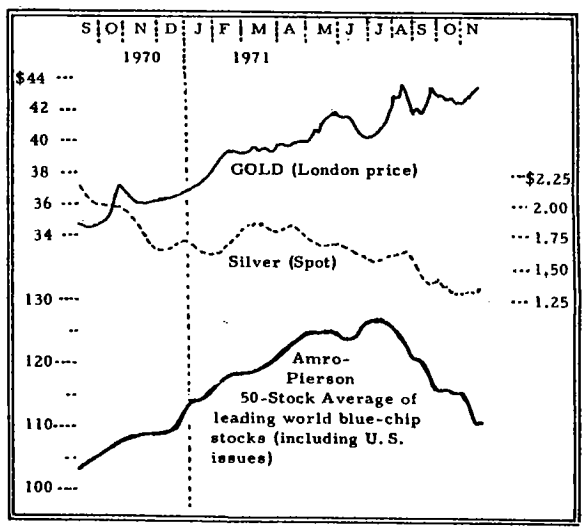
generated overseas, while its primary producing plant is forced to go down the drain."

Down the drain is a harsh expression, but let's glance at the charts of Anaconda (1941 to the present). At its November, 1971, low of 11 1/2, Anaconda, which is the world's leading copper producer and refiner, had actually touched its 1942 low of 30 years ago! Thus roughly 85% of the peak (1969) value of this great enterprise has been washed down the drain.


AMERICAN CAN COMPANY
America's Largest Mfr. of Metal Containers - Also Mfr. of Fibre Containers, Paper Cups, etc.
CAPITALIZATION
Funded Debt . . . $411,000,000
Shares Preferred . . 1,862,000
Shares $12½ Par Com 17,747,000
Split 2 for 1
Split 2 for 1

I am also including the 30-year chart of American Can Co., long considered a defensive, blue-chip stock. Following a "triple top" in the 58-64 area during 1966-68, the stock of this great container company crashed to below 30, or below its 1962 low. This took it to the price it could have been bought at in 1950, just one year after the 1949-66 bull market began. This should give subscribers an idea of the kind of bargains which I believe will appear when this bear market goes through its third and final phase. At this time, I expect quality blue-chip issues to yield an average of 6 to 10%, and fortunes should be made as these once-in-a-generation growth and investment-type stocks are accumulated by the few investors who have the cash and the courage to move in. (All charts courtesy of M.C. Horsey, Salisbury, Md. 21801).


ANACONDA COMPANY (THE)
World's Leading Copper Producer & Refiner - Also Lead, Zinc, Silver, Aluminum & Uranium
CAPITALIZATION
Funded Debt . . . $366,000,000
Shares Preferred . . . None
Shares No Par Common 21,892,000
Split 2 for 1



OBSERVATIONS: The Wall Street Journal carried an ad Nov. 16 for "Transaction". The ad said, "How to Play the Market Without Any Risk! $10." No comment needed here.

I am reading a book by a man who I consider to be one of the most maligned, under-rated, and least understood men of the Twentieth Century. His name is Wilhelm Reich, and he was, to my mind, a great and brilliant genius, whose importance is just now beginning to be hinted at. He died in Lewisburg Federal Prison in 1957, and his books were burned in 1956 and 1960 under the supervision of Food and Drug Administration agents. He was a victim of persecution by his fellow men, persecution on the grounds that he was harming the public by selling boxes with which he thought he could capture the energy of life. He harmed nobody, and nothing he ever wrote harmed anybody. The book I am reading is entitled, prophetically, "The Murder of Christ". I recommend it to every reader (I don't care what religion, if any, you follow) who wishes to catch an incisive view of the past, the present and the future. The book is published by Noonday Press (div. of Ferrar, Straus and Giroux at $2.75 in paperback).

LATE NOTES: There is a violent rally in progress, but this is to be expected after the compression brought on by the September-November collapse. It is imperative that subscribers keep their eyes on the big picture, which is that a primary bear market is on, and that it is going to have its way. All rallies are against the trend; in time they will be forgotten as the main downward force (which began after the 995.15 Dow peak of February, 1966) drives this market to deep-down new lows.